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IN THE
Supreme Court of the United States
OCTOBER TERM, 1998

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM and FLORIDA STATE BOARD OF ADMINISTRATION,
Petitioners,

v.

PAUL FELZEN, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

As petitioners and their *amici* established in their opening briefs, the Federal Rules are properly construed to permit an appeal by objecting shareholders in the circumstances presented here. Pursuant to Federal Rule of Civil Procedure 23.1, those objectors received notice and an opportunity to "show cause" why a proposed settlement should not be approved; they litigated their objections in district court; and the district court's approval of the settlement, if allowed to stand, will have claim preclusive effect on them. Permitting appeal in such circumstances comports with the decisions of this Court and many others allowing *de facto* or *quasi* parties to appeal without formal intervention. It also strongly furthers the clear legislative and judicial policy behind Rule 23.1—providing

federal courts with the information necessary to root out and deter insufficient and collusive derivative suit settlements.

Respondents complain that petitioners "are claiming a power suddenly to convert themselves into litigants by their own will—without any judicial scrutiny, without any opportunity for other parties to object, and without any district-court determination." ADM Br. 19. But the "power" they find so objectionable is precisely what is granted to all shareholders by Rule 23.1. Rule 23.1 specifically contemplates that objecting shareholders have the right to appear and present argument about whether a settlement should be approved—in respondents' words, to "convert themselves into litigants"—*without* formally intervening in the suit.

To be sure, by objecting to a settlement, shareholders do not become parties for all purposes. For that they would need to intervene pursuant to Rule 24—they then would have substantially greater rights (including the right to address other issues in the litigation) and would be subject to the scrutiny that respondents emphasize. But, under the Federal Rules, shareholders who only want to oppose the settlement need not undertake the burden of filing their own complaint, need not subject themselves to mandatory disclosure and discovery obligations, and need not convince the district court of their right to be heard. They are allowed to present their arguments in district court without undertaking such burdens in recognition of the fact that their rights as shareholders are necessarily adjudicated by any proposed settlement. And, if the district court rejects their objections to the settlement, they may make their case—on the same terms—in the court of appeals.

A. This Court's Decisions Uphold the Rights of *De Facto* or *Quasi* Parties To Appeal

1. Respondents spend a great deal of time defending the same simplistic, but plainly incorrect, proposition

adopted by the Seventh Circuit—that only parties may appeal. They claim that this Court has repeatedly held that "persons may not appeal the judgment of a federal court to which they have not been made or sought to become a party." ADM Br. 8-9; *see id.* at 15-26; ADM Directors Br. 22-24; Felzen Br. 8-10, 13-14.

But, in fact, this Court and many others have long held that persons who are not formal parties to the case but whose rights are necessarily being adjudicated *may* appeal. That is the teaching of *Johnson v. Manhattan Railway*, 289 U.S. 479 (1933), where the Court—consistent with centuries of common law precedent—concluded that shareholders who receive notice and present argument in district court are "entitled" to appeal a receivership ruling without intervening. *Id.* at 495 & n.4. It is also the teaching of *United States Catholic Conference v. Abortion Rights Mobilization, Inc.*, 487 U.S. 72, 76 (1988); *Williams v. Morgan*, 111 U.S. 684 (1884); *Blossom v. Milwaukee R.R.*, 68 U.S. (1 Wall.) 655 (1864), and the multitude of other cases cited in our opening brief and in the Solicitor General's *amicus* brief. *See* Pet. Br. 18-19, 24-27 & nn.21-26; Gov't Br. 7-11 & nn.1-4.

Thus, the rule allowing *de facto* or *quasi* parties to appeal is by no means a novel one; rather, it is moored in centuries of decisions rendered by this Court and many others. As Judge Learned Hand explained, while the general rule is that persons who are not formal parties may not appeal because their rights are "not concluded by the decree, and [they are] not therefore aggrieved by it," this Court's cases demonstrate that where a judgment "affects [that person's] interests, he is often allowed to appeal." *West v. Radio-Keith-Orpheum Corp.*, 70 F.2d 621, 624 (2d Cir. 1934) (citing, *inter alia, Blossom* and *Morgan*). *See also* 15A Charles A. Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice and Procedure* § 3902.1, at 122 (2d ed. 1992) ("Nonparties need not always go through a formal intervention procedure to achieve standing to appeal.").

Indeed, the very cases that ADM highlights (at 22) undermine its broad assertion. In *Karcher v. May*, 484 U.S. 72 (1987), the Court stated that the proposition that only formally admitted parties may appeal was a "*general rule*," not an exceptionless command. *Id.* at 77 (emphasis added). Both *Bayard v. Lombard*, 50 U.S. (9 How.) 530, 551 (1850), and *United States ex rel. Louisiana v. Jack*, 244 U.S. 397, 402 (1917) (citing *Ex parte Leaf Tobacco Bd.*, 222 U.S. 578 (1911)), state that the category of permissible appellants includes "*privies to the record*"—a class that has been determined to include shareholders that seek review of derivative suit settlements.[1] Other cases cited by respondents similarly confirm that the right to appeal extends to persons treated as parties by the trial court[2]—a category that, if it is to

[1] Relying on D.C. Circuit precedent (as well as other cases having nothing to do with which persons may appeal), ADM suggests (at 24) that the term "privies" refers only to successors to a property interest. But, in a more recent case that ADM ignores, the D.C. Circuit explicitly concluded that the *precise class of persons at issue here*—shareholders who object to derivative suit settlements—are "privies to the record" that may appeal because "judgments in such cases bind shareholders." *United States v. LTV Corp.*, 746 F.2d 51, 53-54 & n.5 (D.C. Cir. 1984).

Even in the D.C. Circuit case highlighted by ADM, *United States v. Seigel*, 168 F.2d 143 (D.C. Cir. 1948), the court of appeals discussed with approval Judge Learned Hand's earlier conclusion that a creditor who appeared to object to a receivership could appeal because, though not a formal party, "he was actually present and participating in the proceeding below after appearance upon notice duly given him." *Id.* at 145 (citing *West*, 70 F.2d at 623-24). That, of course, is precisely the case here. Moreover, the *Seigel* court approvingly quoted Judge Hand's decision in *West*: "'generally speaking no person, not a party to a suit, may appeal . . . [*b*]*ut if the decree affects his interests, he is often allowed to appeal.*'" *Id.* (quoting *West*, 70 F.2d at 623-24) (emphasis added). It is hard to imagine a statement that more directly undermines respondents' absolutist position.

[2] *Karcher*, 484 U.S. at 77; *Ex parte Cockcroft*, 104 U.S. 578, 578-79 (1882); *Ex parte Leaf Tobacco Bd.*, 222 U.S. 578, 578 (1911); *Ex parte Cutting*, 94 U.S. 14 (1877).

have meaning at all, must include persons who have received a legally mandated notice of court proceedings, who are entitled to present argument on that question before the trial court, and who will be subject to claim preclusion if a settlement is approved. *See* Pet. Br. 14-19; Gov't Br. 12-15.

Certainly, none of respondents' proffered cases involved persons whose rights were subject to claim preclusion once the case was decided and who were summoned to appear and show cause in trial court proceedings. *See, e.g., Ex parte Cockcroft*, 104 U.S. at 578 (denying appeal by party who "did not make it appear that he had any real interest in the controversy"); *Payne v. Niles*, 61 U.S. (20 How.) 219, 220 (1857) (person who had never sought relief directly against judgment debtor could not appeal judgment); *Connor v. Peugh's Lessee*, 59 U.S. (18 How.) 394, 395 (1855) (tenant who did not contest ejectment prior to judgment could not appeal).[3]

[3] Nor can law review articles plug this gaping hole in respondents' argument. Such articles, of course, cannot trump the decisions of this Court. In any event, the cited articles do not involve objectors under Rule 23.1, and they do not state the exceptionless rule respondents champion. Rather, as the language respondents quote suggests, they generally deal with particular circumstances involving, for instance, the rights of *amici curiae*. Respondents also twice cite Professors Levi and Moore for the statement that someone who "has not intervened, has no right of appeal." Levi & Moore, *Federal Intervention II: The Procedure, Status, and Federal Jurisdictional Requirements*, 47 Yale L.J. 898, 938 (1938). But the key case cited in that article, *In re Trust No. 2988*, 85 F.2d 942 (7th Cir.), *cert. denied*, 299 U.S. 609 (1936), involved an attempt by a bondholder to appeal on matters *other than those* as to which he was entitled to (and did) argue in district court. *See id.* at 943. That case has long been understood to be consistent with the proposition that *de facto* parties could appeal on issues that they were entitled to argue in the trial court. *See In re South St. Bldg. Corp.*, 140 F.2d 363, 367 (7th Cir. 1943) (distinguishing *Trust No. 2988* from instances where a stockholder or credit holder was a "party in interest" and "[f]ormal intervention was not required"

2. In the end, respondents are forced to abandon the absolutist proposition adopted by the Seventh Circuit. They acknowledge that some persons who are not formal parties may appeal.[4] Having discarded the Seventh Circuit's *reasoning*, however, respondents struggle to save its *result* with a series of newly minted limitations that, in their view, do not authorize objector appeals in this context.

For the reasons we discuss below, respondents' arguments on these points are no more persuasive than their primary submission. For now, however, the crucial point is that respondents' concession that some persons who are not formal parties may appeal fatally undermines their claims (*see* ADM Br. 18, 50) that this Court's cases mandate that *all* persons intervene before appealing and that a revision to the Federal Rules would be necessary to

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for purposes of appeal), *cert. denied*, 322 U.S. 761 (1944); *Rogers v. Consolidated Rock Prods. Co.*, 114 F.2d 108, 110 (9th Cir. 1940).

Professor Kaplan's footnote statement (cited at ADM Br. 14) about the right to appear and "receive papers" under Rule 23(c)(2)(C) says nothing about the right to be heard on settlements under Rule 23.1. His suggestion (cited at ADM Br. 16) about the inability of non-intervenors to "stop a settlement" by their disagreement says nothing about those persons' ability to object to a settlement in an effort to have a court disapprove it; and his statement about those persons' inability to appeal a case that has been *litigated* to judgment ("entered after contest") is notable for the fact that it does not speak to appeals from approved settlements.

[4] *See* ADM Directors Br. 34 (acknowledging cases where "non-parties with genuine, direct interests in the proceedings" were permitted to appeal); ADM Br. 30-36 (discussing appeals by *de facto* parties, by persons who are summoned or ordered, but are not parties, and by "disputants in ancillary proceedings"). The Felzen respondents purport to defend the proposition that only parties may appeal, but do so only by extending that term to include "non-formal" parties, a category that is functionally no different from the category that others have described as non-parties. *See* Felzen Br. 18.

permit appeals by *de facto* or *quasi* parties in this context.[5] Rather, intervention provides an *alternative* for persons who want the much greater rights associated with full party status—most basically, the right to be heard and to appeal on many issues *other* than the approval of the settlement. *Contrast* Felzen Br. 17 (wrongly suggesting that objectors want to be "super parties" with all the benefits of party status without any of the burdens).

Respondents' admission also fatally undermines any suggestion that *Marino v. Ortiz*, 484 U.S. 301 (1988), and/or Federal Rule of Appellate Procedure 3(c) absolutely bar all appeals by persons who are not parties.[6] The only question before the Court, therefore, is whether there is some *other* basis that the Seventh Circuit did not think of to support that court's conclusion that objecting shareholders may not appeal. As we now explain, there is not.

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[5] That concession also refutes the argument that this Court lacks jurisdiction over any petition that is not submitted by a formal party to the case. *See* ADM Br. 1. In any event, as the appellants in this matter, petitioners *were* parties to the court of appeals proceeding, even if they were not parties in the district court. Indeed, a rule that allowed persons to appeal to the court of appeals under 28 U.S.C. § 1291 (which, as we explained in our opening brief, never mentions party status), but precluded them from petitioning this Court would have the perverse effect of preventing the Court from serving its core function as the final arbiter of federal law.

[6] ADM's attempt (ADM Br. 19-21) to defend the Seventh Circuit's reliance on Rule 3(c) is thus ultimately beside the point. In any event, ADM never explains how the Seventh Circuit's understanding of that rule may be squared with Federal Rule of Appellate Procedure 1(b)'s statement that "[t]hese rules *shall not be construed to extend or limit the jurisdiction of the courts of appeals as established by law*" (emphasis added). *See* Pet. Br. 29. The decisions ADM quotes discuss only the need to comply with Rule 3(c)'s procedural requirements to invoke the court of appeals' jurisdiction; they do not purport to suggest that Rule 3(c) meant to, or does, limit the *kinds* of persons that may appeal. *See Torres v. Oakland Scavenger Co.*, 487 U.S. 312, 318 (1988) (holding that "et al." reference in notice of appeal did not provide sufficient indi-

B. Respondents' Arguments for Denying Objecting Shareholders the Right To Appeal Are Unpersuasive and Reflect a Misunderstanding of Derivative Suits

After grudgingly acknowledging that *some* persons who are not formal parties may appeal, respondents assert that shareholder objectors do not fall within the scope of the decisions permitting such appeals. Respondents proffer two primary distinctions between shareholder objectors and other *de facto* party appellants: (1) shareholder objectors are allegedly not "summoned" into court in the same way these other appellants are; and (2) shareholders do not have a sufficiently "direct" interest to support a right to appeal. Neither argument withstands scrutiny.

1. Respondents contend repeatedly that, unlike the *de-facto* parties that have been permitted to appeal, petitioners were not "summoned" or "haled into court." ADM Br. 26-27, 31-33; ADM Directors Br. 35-37; Felzen Br. 18-19. In fact, petitioners here are in precisely the same position as the appellants in *Manhattan Railway*, in *Christian v. R. Hoe & Co.*, 63 F.2d 218, 218 (2d Cir. 1933) (cited with approval in *Manhattan Railway* for permitting *de facto* party appeal), in *Cohen v. Young*, 127 F.2d 721, 724 (6th Cir. 1942), and in the other cases cited in our opening brief (at 21-22). In those cases, as here, appellants received a court notice informing them of the pendency of proceedings that affected their rights, that would subject them to claim preclusion, and that required them to appear to "show cause" *if they wished to be heard before the matter was finally adjudicated.* Respondents' suggestion that appellants in these cases were "compelled" to appear in some meaningfully different way than here is simply untenable. Respondents do not—and cannot—seriously claim that the corporate shareholder and bondholder appellants in *Manhattan Railway* and in *Christian*

cation that non-named party intended to appeal); *Smith v. Barry*, 502 U.S. 244, 245 (1992) (holding that document intended to serve as an appellate brief may qualify as a notice of appeal).

would have been hauled off by a Federal Marshal or held in contempt if they did not appear in court at the appointed time. In fact, the *Manhattan Railway* appellants did not appear in response to the court's "invit[ation]" to "show cause" (289 U.S. at 495), without any apparent consequence *except* the loss of their right to be heard on the relevant issue. *See id.*[7]

The full implausibility of respondents' argument is demonstrated by their attempts to distinguish *Cohen* on this ground. *See* ADM Br. 26.[8] In fact, *Cohen* involved the exact same situation as this case: the appellant was a shareholder objector who was notified under what is now Rule 23.1 to "show cause" why a derivative settlement should not be approved and who had appeared in district court to contest the settlement's fairness. *See* 127 F.2d at 724; Order Preliminarily Approving Settlement and Providing for Notice at 3 (May 30, 1997 (R.62)) (directing interested shareholders to "appear and show cause, if he, she or it has any [reason] why the proposed settlement of the derivative claims . . . should or should not be entered thereon").[9]

[7] Unable to come up with a legally relevant distinction for *Manhattan Railway*, respondents resort to labeling the case "unusual" (ADM Br. 22 n.22) and suggesting that the Court did not "focus[]" on the appellate jurisdiction issue (Felzen Br. 19). In fact, the Court addressed the relevant question and specifically cited cases that squarely authorized *de facto* party appeals *without intervention*. *See* 289 U.S. at 495 n.4.

[8] As respondents note, the Sixth Circuit itself has recently proffered this highly strained reading of *Cohen*. But the court's subsequent reading of that case was influenced by the same misinterpretation of *Marino* that infects respondents' briefs and the Seventh Circuit decision below and which we have shown cannot be squared with this Court's case law. *See Shults v. Champion Int'l Corp.*, 35 F.3d 1056, 1060-61 (6th Cir. 1994) (reading *Cohen* in light of an overly expansive understanding of *Marino*); *Wilkenson v. Hercules Engines, Inc.*, 138 F.3d 608, 611 (6th Cir. 1998) (applying *Shults*).

[9] Contrary to ADM's suggestion (ADM Br. 26), the fact that the appellant attempted to intervene played no part in the *Cohen* deci-

In sum, like petitioners here, the appellants in all these other cases were "haled into court" in the sense that the court alerted them that their rights would be finally adjudicated in their absence unless they appeared at the appointed time.

The fallacy in respondents' proffered distinction is further demonstrated by the fact that respondents acknowledge that situations exist where *de facto* parties are allowed to appeal even though they appeared in the trial court of their own volition—and thus could not conceivably have been "haled" into the matter. As the Solicitor General has explained in his *amicus* filing, cases such as *Blossom* (which involved bidders at a foreclosure sale) and *Williams* (which involved bondholders who had sought "leave to be heard" in the trial court as to certain trustee charges (111 U.S. at 693)) demonstrate that persons who have participated in the relevant trial court proceedings and whose rights are necessarily implicated by the order at issue may appeal as *quasi* parties, whether or not they have been "haled into" the proceeding against their will. *See* Gov't Br. 7-12.[10] Respondents similarly do not dispute that sureties that particiapte in district court proceedings may appeal in some instances even though they too appear purely on their own initiative. *See* Pet. Br. 26 & n.25.

2. Respondents ultimately retreat to a different, but equally untenable, distinction. They concede that "quasi

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sion. In fact, the court specifically stated that the failure to appeal the intervention denial was "not decisive" of appellant's right to appeal. 127 F.2d at 724.

[10] ADM suggests that these cases are distinct because they involved "ancillary proceedings." ADM Br. 33. The relevance of that distinction is elusive at best. The bidder appellant in *Blossom*, for instance, was surely not a formal party to the ancillary proceeding, and did not "subject itself to the jurisdiction" (*see id.* at 34) of the trial court to any greater extent than did petitioners here, who appeared at the time appointed by the district court to attempt to persuade the court as to how it should adjudicate their interests.

parties . . . with a direct financial interest in a proceeding" may appeal. ADM Directors Br. 39; *see* Felzen Br. 18. But, because a derivative suit recovers money for the corporation, not the individual shareholders, respondents reason that shareholders' interests in a derivative suit are not sufficiently "direct" to allow them to invoke the authority of an appellate court. *See* ADM Directors Br. 32-34; ADM Br. 25-26; Felzen Br. 15-17.

But the argument that shareholders lack a sufficiently concrete stake in derivative cases to invoke a federal court's authority simply second-guesses the judgment behind Rule 23.1. One might imagine a legal system in which shareholders' interests were understood to be too indirect to invoke a federal court's authority. But that is not our system. On the contrary, Rule 23.1, which largely codifies this Court's earlier decision in *Hawes v. City of Oakland*, 104 U.S. 450 (1881), represents an express judicial and legislative judgment that shareholders *are* sufficiently affected by harms to the corporation's interest that they may sue for a wrong done to the corporation. Accordingly, the question of the "directness" of a shareholder's interest has already been resolved—by this Court and by Congress in promulgating Rule 23.1. As the Solicitor General has explained, under Rule 23.1 "[o]wnership of the corporation's stock . . . gives both the objecting shareholder and the plaintiff shareholder a shared interest in the outcome of the case." Gov't Br. 13.

Moreover, as we have emphasized throughout, an objecting shareholder's direct and significant interest in the outcome of the litigation is demonstrated by the specific requirement that all shareholders be provided notice and an opportunity to be heard before a settlement is approved. It is precisely because a settlement would have claim preclusive effect on all shareholders' rights that the Federal Rules require that all shareholders be notified and permitted to present their arguments against a settlement during court proceedings. It is that same interest that permits them to appeal an adverse decision. *See, e.g., In re Pitts-*

burgh & Lake Erie R.R. Sec. & Antitrust Litig., 543 F.2d 1058, 1069-70 (3d Cir. 1976) (shareholders may appeal derivative suit since their "equity is being diluted"; their "distinctive interests are as worthy of consideration and protection as [party] shareholders"); *LTV Corp.*, 746 F.2d at 53-54 n.5 (objectors may appeal settlement approvals in derivative context because "judgments in such cases bind shareholders").[11]

Finally, respondents' emphasis on shareholders' supposed lack of a direct interest in the litigation is undermined by their own briefs. Respondents elsewhere stress that, "*a fortiori*," the decision in this case must apply in the class action context. ADM Br. 39-40. *See also* Pet. Br. 30 & n.29 (discussing the identity of language on objector rights in Rules 23(e) and 23.1). Yet even the Seventh Circuit conceded (Pet. App. 4a) that absent class members have a *direct* stake in the litigation. Accordingly, the alleged "indirectness" of shareholders' interests cannot provide a basis for resolving this case. *See also* 15A

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[11] ADM acknowledges that, before this case, *every* court of appeals to address this issue had concluded that shareholders may appeal without intervening. *See Cohen, supra*; *Tryforos v. Icarian Dev. Co.*, 518 F.2d 1258, 1263 n.22 (7th Cir. 1975) (Stevens, J.), *cert. denied*, 423 U.S. 1091 (1976); *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304 (3d Cir. 1993); *see also Gottlieb v. Wiles*, 11 F.3d 1004, 1011 (10th Cir. 1993). ADM argues, however, that the case law in the class action context is to the contrary. *See* ADM Br. 28-30. In fact, ADM ignores much case law recognizing the right to appeal in that context. *See, e.g., In re PaineWebber Inc. Ltd. Partnerships Litig.*, 94 F.3d 49, 53 (2d Cir. 1996); *Carlough v. Amchem Prods., Inc.*, 5 F.3d 707, 713-14 (3d Cir. 1993); *In re Cement Antitrust Litig.*, 688 F.2d 1297, 1309 (9th Cir. 1982), *aff'd sub nom. Arizona v. United States District Court*, 459 U.S. 1191 (1983); *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173, 1175 (9th Cir. 1977). And the cases ADM cites post-date and mistakenly rely upon *Marino* and *Guthrie v. Evans*, 815 F.2d 626, 628 (11th Cir. 1987). As one set of *amici* has explained, *Guthrie* did not even involve a settlement, and it has unfortunately led to incorrect decisions in a few circuit courts. *See* Brief *Amicus Curiae* of Public Citizen, Inc., *et al.*, at 11-17.

Wright, *et al., supra*, § 3902.1, at 129 ("[t]he determination whether to permit nonparty appeal does not rest alone on the directness . . . of the effects caused by an order").

C. The Policy Reasons Advanced by Respondents for Requiring Formal Intervention Are Unpersuasive

1. Respondents and their *amicus* do not dispute that in derivative litigation plaintiffs' counsel and defendants have strong incentives to settle for a small judgment and a large legal fee. Pet. Br. 13-14. They do not dispute that objecting shareholders help expose and prevent improper derivative settlements in the district court. Pet. Br. 32-33; WLF Br. 18 (citing additional authorities). They do not dispute that objecting shareholders serve this same function on appeal, providing strong incentive for district courts to take seriously shareholder objections and an avenue for correcting district court errors. Pet. Br. 33; WLF Br. 21-23 (citing additional authorities).

Instead, respondents deride these points as "policy arguments" that do not justify "rewriting" the plain language of the Federal Rules. ADM Br. 47-50; Felzen Br. 16-27. The unspoken premise of this argument, however, is that the text of the Federal Rules somehow *compels* intervention in all circumstances. Respondents have not produced —and cannot produce—a shred of support for such a conclusion. On the contrary, for all the reasons we have previously discussed, it is well-established that *de facto* parties may appeal without intervening.

Nor are respondents correct in deriding petitioners' points as mere "policy arguments." The federal courts charged with applying Rule 23.1 have themselves noted not only the absence of any statutory, regulatory, or constitutional impediment to objecting shareholder participation, but also the critical assistance objecting shareholders provide them in assessing the fairness and adequacy of derivative settlements. *See, e.g., Bell Atlantic*, 2 F.3d at 1310; *Gottlieb*, 11 F.3d at 1010-11; Pet. Br. 13-15 (citing additional authorities); Pet. 14-15 n.15 (same).

2. By contrast, it is respondents who manufacture "policy arguments" without any basis in Rule 23.1's language, history, or practice. They assert that requiring intervention will help deter the "proliferation" of appeals. Felzen Br. 23; ADM Br. 47. But the government, which bears responsibility in assisting in the administration and development of the Federal Rules, confirms that they "do not evince a concern that [the] limited degree of participation by persons other than the named plaintiff will unduly disrupt the litigation or render it unmanageable." Gov't Br. 28.

Respondents do not cite a single federal court that has ever claimed to be overworked by objecting shareholder appeals. In fact, petitioners have found just four reported objector appeals since 1990. Pet. Br. 37-38. ADM's own research reveals just 25 derivative settlement appeals during the 25-year period 1971-1996. ADM Br. 43. This is hardly evidence that the courts of appeals merit further insulation from a supposed tide of shareholder appeals. By contrast, respondents' rule would undeniably create additional work for overworked federal district courts by requiring them to resolve needless intervention motions. *See* Pet. Br. 38-39.

Respondents argue that requiring intervention would advance the social policy of "encouraging settlement." ADM Br. 45-46. None of respondents' arguments or authority, however, addresses settlement in the shareholder derivative suit context. In this peculiar arena, enormous and undisputed pressures *already* "encourage settlement"—even to the point of inducing collusive and improper deals. *See* Pet. Br. 13-14. Respondents cannot seriously argue (or cite any authority suggesting) that additional incentives to settlement are necessary or warranted. To the contrary, virtually every derivative suit brought today *is* settled. *See* Interview with Todd Foster, National Economic Research Associates (Dec. 21, 1998) (out of 371 derivative suits between 1975 and 1997, only five were

tried through verdict). Meanwhile, courts and commentators agree that further "hurdles" to objecting shareholder participation should be avoided in order to ensure courts sufficient adversarial information to assess the fairness of such deals. Pet. Br. 13-14 (citing authority); *Bell Atlantic*, 2 F.3d at 1310; *Cohen*, 127 F.2d at 725; WLF Br. 18-19 (citing further authority).[12]

Respondents chide us for lacking sufficient confidence in the trial courts to assess shareholders' objections without appellate oversight. Felzen Br. 25; ADM Br. 42. But respondents' own research reveals that reversals were obtained in fully 20 percent of derivative settlement appeals heard from 1971 through 1996. ADM Br. 43 (5 of 25 reversed).[13] This reversal rate parallels the national average

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[12] Felzen argues that the intervention requirement advances the related goal of providing "certainty as to when the litigation is over," noting that "[i]f no objector moves to intervene and the district court approves the settlement and enters judgment, the parties can be certain that the litigation is at an end." Felzen Br. 23. But the case is no more over if objecting shareholders appeal the denial of their intervention motions than if they appeal the denial of their objections to the settlement.

[13] ADM claims that of the five reversals, "only one rejected a settlement on the merits." *Id.* This is grossly misleading. In fact, each of these cases illustrates why access to the courts of appeals is essential. Courts variously reversed in these cases because the proposed attorney fees were too high; the parties' proposed settlement was too low; the fairness of the settlement was impossible to determine because the trial court had impermissibly silenced objecting shareholders; or there was compelling evidence of director collusion. *See Rosenbaum v. MacAllister*, 64 F.3d 1439, 1448 (10th Cir. 1995) (remanding $2.6 million attorney fee award, which trial court later reduced by $1.4 million, *see* Pet. Br. 33); *Saylor v. Bastedo*, 623 F.2d 230, 232-33 (2d Cir. 1980) (Friendly, J.) (court ordered reconsideration of settlement earmarking $250,000 for attorney fees and just $57,000 for stockholders when claim had a face value of "many millions" that had "sufficient support . . . to prompt this court to observe that 'plaintiff was not far from making a *prima facie* case' "); *Girsh v. Jepson*, 521 F.2d 153, 156-60 (3d Cir. 1975) (remanding because trial court denied objecting

for all civil cases, underscoring that appellate review and error correction is as warranted here as in any civil setting. Pet. Br. 33 (reporting civil reversal rates of between 16 and 27 percent). It is hardly an indictment of federal trial courts to acknowledge that some improper settlements may evade their detection; the Third Circuit has itself expressly worried about just this possibility. *Bell Atlantic*, 2 F.3d at 1310.

3. Nor is there any doubt that under respondents' rule objecting shareholders would be effectively barred from appealing. Respondents abandon their prior intimations that the Court should rewrite Rule 24 to make shareholder intervention easy and costless.[14] Nowhere in their briefs do they dispute that objecting shareholders' motions to intervene would have a hard time meeting Rule 24's "timeliness" and "adequate representation" tests. Pet. Br. 34-35. To the contrary, ADM offers only the cold comfort that objecting shareholders could bring separate lawsuits against company directors when they can prove outright fraud by the parties in the original derivative litigation. ADM Br. 45. Felzen similarly notes only that objectors would be able to appeal denials of intervention. Felzen Br. 26. Such an appeal would, however, be a fruitless formalism if any intervention motion could be properly denied under Rule 24 as respondents now suggest.[15]

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shareholders participation and, as a result, court lacked sufficient information to assess settlement's fairness); *Clark v. Lomas & Nettleton Fin. Corp.*, 625 F.2d 49 (5th Cir. 1980) (vacating and remanding where evidence suggested directors collusively settled suit), *cert. denied*, 450 U.S. 1029 (1981).

[14] *Compare* ADM Br. in Opp. 16 *and* ADM Directors' Br. in Opp. 14-15 *with* ADM Br. 18 (arguing compliance with Rule 24 should not be "an empty formality").

[15] Felzen dismisses petitioners' "fear of discovery" as mere "speculation." Felzen Br. 26. But the practical disincentives associated with intervening are wholly beside the point if (as respondents no longer contest) any intervention motion would be denied as a matter of law. Pet. Br. 34-35. Besides, members of the judiciary have recognized that the practical disincentives associated with accepting discovery obligations can be staggering even for large institutional investors. *See* Pet. Br. 35-36 (quoting District Judge Vaughn R. Walker). To take but one recent example, as soon as the Wisconsin Investment Board assumed the "lead plaintiff" role in a recent securities fraud class action pursuant to the Private Securities Litigation Reform Act of 1995 it was immediately pummeled with irrelevant and harassing demands for all documents concerning the performance of its investments and for depositions of its officers. *See Gluck v. Cellstar Corp.*, No. 3:96-CV-1353-R (N.D. Tex.).

In the end, respondents would have the Court chase the policy goal of "encouraging settlement" in an arena where virtually all cases already settle—even if it means extinguishing appeals by objecting shareholders whose rights are directly affected and finally adjudicated, insulating many derivative suit settlements from federal appellate court review designed to ensure that they are not insufficient or even the product of collusion, tolerating an error rate of 20 percent or more, and imposing a new round of motion practice on busy federal district courts. Nothing in the Constitution, federal statutes, or the Federal Rules of Civil Procedure supports such a result, and both this Court's cases and common law tradition point in exactly the opposite direction.

CONCLUSION

The Seventh Circuit's order dismissing petitioners' appeal should be reversed.

Respectfully submitted,

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